Risk and CSR Reporting:
A Case Study of AEP’s Corporate Accountability Report

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Abstract

RISK AND CSR REPORTING:
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Many executives are under intense scrutiny to understand the risks associated with their company strategies because unforeseen risks can drastically affect a company’s stock price and financial viability. Since the inception of the Sarbanes-Oxley Act of 2002 (SOX) companies have had to demonstrate through business reporting that the company not only understands the connection of strategy to risks, but must also be able to quantify the impact of risks, as well as demonstrate plans of action to deal with risks as they occur. Reporting risks are specifically important because they are the company’s most complete display of its performance and can directly changes how investors determine the stock price of the company – a key factor for all publicly traded companies.

One way companies can quantify and report its risk is through Corporate Social Responsibility (CSR) reporting. AEP created the 2010 Corporate Accountability Report to demonstrate to stakeholders that the company is being a positive force in society and in the world. Yet some companies, like BP, have created CSR reports that do not align reality with what the company is reporting. The impact of poor CSR reporting is that some companies produce quality information for stakeholders while others greenwash its reports to look good for stakeholders, making CSR reports difficult for readers to believe and compare against other companies and across time periods.

This report assesses the accountability and comparability of AEP’s 2010 Corporate Accountability Report to demonstrate that the company still has room for improvement in how it reports. This was accomplished by utilizing AEP’s Integrated Enterprise Risk Model (ERM) to understand the company’s environmental and safety strategy, the associated risks and stakeholders, and how AEP reports on these issues to determine the strengths and weaknesses of the report. Then AEP’s organization model and risk management strategies were used to lay ground for assessment. After the groundwork was laid out, this report focused on the environmental, safety, and health (ESH) reporting group to identify the risks in the Corporate Accountability Report in conjunction with the two challenges of reporting – accountability and comparability. Through this assessment it was shown that the CSR report received a “satisfactory” in terms of meeting the reporting challenges because the report correctly assessed the assumptions and attempted to be accountable, but lacked strong comparability and omitted some risks that could be critical to the business’ long-term sustainability.
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Introduction:

Many executives are under intense scrutiny to understand the risks associated with their company strategies because unforeseen risks can drastically affect a company’s stock price and financial viability. Since the inception of the Sarbanes-Oxley Act of 2002 (SOX) companies have had to demonstrate through business reporting that the company not only understands the connection of strategy to risks, but must also be able to quantify the impact of risks, and demonstrate plans of action to deal with risks as they occur. Reporting risks is specifically important because they are the company’s most complete display of its performance and can directly change how investors determine the stock price of the company – a key factor for all publicly traded companies.

Currently, SOX regulation mandates that all publicly traded companies must report on the management of risks from three key perspectives: internal control, corporate governance, and external attestation. However many companies wish to better quantify and report its risk management strategies by using the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework, which develops an extensive understanding of controls and risk management. COSO, among others systems, is a framework that attempts to effectively control risk from an enterprise risk management (ERM) perspective that focuses on looking at corporate-wide risks and how they can kept within an organization’s risk appetite (COSO Report 2004).

Another way companies can quantify and report its risk is through Corporate Social Responsibility (CSR) reporting, which is a long-term reporting model that attempts to portray more than the simplistic financial portions of a business (Ballou And Heitger 2008). Traditionally, companies have used CSR reporting to demonstrate to stakeholders that the company is being positive force in society and in the world. This does not mean, however, that most companies have linked ERM strategies with CSR reporting because these business segments are often perceived as being different and unlinked. Yet companies weaken both ERM strategies and CSR reports because “opportunity costs and long-term value are harder to show unless [they are] properly linked to strategy and risk” (personal communication with Brian Ballou 2011). CSR reporting can help a business understand a variety of external risks that affect the business through its relationship with stakeholders and, by properly connecting ERM and
CSR reporting, companies can better manage these risks thus making the company’s risk-understanding more complete.

Not linking CSR reporting and ERM strategies leads to two major problems with CSR reporting: accountability and comparability. Though many executives understand the need to use nonfinancial reporting in conjunction with risk management most do not understand how to connect the two or, more commonly, how to effectively quantify the link (Ballou and Heitger 2008). This lack of understanding leads companies to reduce the quality of the information that is presented by reporting qualitatively on their role in society or in the environment, which leads to poor reporting accountability at best and “greenwashing,” or misrepresentation of environmental information, at worst (Institute for Responsible Investors 2010).

Another major problem in CSR reporting is comparability. This is partially based on the location of the company’s headquarters and partially based on the lack of regulatory standards currently available. For instance, France and Sweden mandate all publicly traded businesses located within the countries’ borders to produce CSR reports, thus forcing better comparability. In contrast, companies in the United States of America approach quantifiable CSR reporting hesitantly because the legal ramifications are extremely high. This shows a disparity in the quality of reports based on the reporting location which affects the disparate efficacy of the reports produced in different regions around the world (Eccles and Krzus 2010).

Even though U.S. litany makes CSR reporting difficult some companies are making strides to connect ERM and CSR reporting in a more comparable manner. One such company that is leading the U.S. electrical industry in CSR reporting is American Electric Power (AEP). AEP is one of the United States’ largest generators and transmitters of electricity spanning the eastern portion of the U.S. from central Ohio to parts of Texas, Louisiana, and Arkansas. The company is publicly traded at approximately $35 per share with 2009 revenue of $13.5 billion. AEP is also the largest user of coal in the U.S. with 66% of its power being generated from various U.S.-derived coals. This reliance on coal demonstrates that the success of the business is currently linked to AEP’s ability to cheaply produce coal, reliably generate power, and consistently distribute electricity to customers (AEP Corporate Accountability 2010).

Since AEP has attempted to link its ERM model with CSR reporting, it should be apparent that the company’s recent CSR reporting demonstrates that the company can manage the two major problems with CSR reporting: accountability and comparability. The reality is that
companies run into difficulties associated with accountability and comparability in CSR reporting because these two problems are difficult to understand and manage. For instance, BP is an example of a company that has a long history with CSR reporting yet the reports the company has produced seem less valuable after the 2010 oil spill of 205 million gallons of oil in Gulf of Mexico because it is now obvious that the company poorly reported on its safety, health, and environmental risks and impacts. The impact of poor CSR reporting about BP’s practices and controls in these areas show the huge risks associated with CSR reporting and the importance for companies like AEP to link the risks associated with CSR reporting to the company’s objectives and strategies. It also demonstrates the importance of making reports accountable and comparable because it shows that BP essentially greenwashed its CSR report to look good for stakeholders when the reality is that the company was being unsustainable.

This report assesses the accountability and comparability of AEP’s The 2010 Corporate Accountability Report to demonstrate that the company still has room for improvement in how it reports. To accomplish this goal the company’s ERM Integration Model was first used to develop an understanding of the company’s environmental and safety strategy, the associated risks and stakeholders, and how AEP reports on these issues to determine the strengths and weaknesses of the report. Then AEP’s organization model and risk management strategies were used to lay ground for assessment. After the groundwork is laid out, this report focused on the environmental, safety, and health (ESH) reporting group to identify the risks of the Corporate Accountability Report in conjunction with the two challenges of reporting – accountability and comparability. Through this assessment it was shown that the CSR report received a “satisfactory” in terms of meeting the reporting challenges because the report correctly assessed the assumptions and attempted to be accountable, but lacked strong comparability and omitted some risks that could be critical to the business’ long-term sustainability.

Background on AEP: Necessity of CSR Reporting

AEP is currently in a precarious position because electricity generation is a partially regulated industry in the United States. This means that some states regulate the price per kilowatt hour – i.e. Ohio – while other states allow the wholesale market to dictate price per kilowatt hour – i.e. Michigan. This adds layers of complexity for companies like AEP because it demands a better understanding of cost control and specified market prices, while also infringing
on possible profits based on set rate costs. One AEP executive noted that in Virginia AEP actually lost money in 2009 because the company was denied a rate increase proposal and had to engage higher prices elsewhere to make up for the lost profits (personal communication with Laura J. Thomas 2011). This example demonstrates the difficulty for companies like AEP to compete in partially regulated industries because they are subjected to restricted revenue streams and must focus on staying low cost to be competitive.

The nature of the electricity generation and distribution industry also demands that AEP is under much heavier regulatory restrictions in the areas of affirmative action, environmental protection, and financial reporting. To counteract the risk of high regulatory costs AEP must spend an inordinate amount of money on a regulatory division and lobbying to ensure that one regulation will not dictate the going concern of the company. Couple these regulations and lobbying costs with complex rate issues and pricing issues and it becomes obvious how complex AEP’s “basis” business model and strategic focus must be to adapt to these various stimuli in a cost effective manner.

Along with heavy regulation, the coal-producing electric industry is under heavy scrutiny because of environmental factors. The Intergovernmental Panel on Climate Change (IPCC) overwhelmingly supported anthropogenic affect on a changing climate, with coal generation leaving a heavy footprint on our planet (IPCC 2007). In fact, critics of the report say that the report is overly conservative on issues like rising sea level due to the heavy influence of governmental consensus, which further demonstrates the importance for companies like AEP to focus on its environmental impact (Stein, 2007).

Furthermore, there are many groups pushing coal-generating companies to reduce their mountaintop mines, waterway and air pollution, and local community impact (Personal communication with Elisa Young 2010). These NGO’s and activist groups are ubiquitous throughout society and focus on the negative health impacts of coal-fired electricity generation on the local communities and portray companies like AEP as “uncaring” (Personal communication with Sandy Nessing). This negative image demands electricity companies to manage relations with the public to ensure society-wide acceptence.

Another environmental risk that is specifically important for coal-fired electricity generation is the societal costs associated with emissions. For instance, it has been recognized by the EPA that mercury and other toxic chemical air emissions are harmful to individuals and
communities located nearby the power generators. Because of this impact the Environmental Protection Agency (EPA) is currently putting federal regulations in place to further limit the amount of mercury and other toxic chemicals in emissions. This regulation is important for AEP for two reasons: first, scientists are continually demonstrating the linkage between coal-fired power generation and increased health problems –i.e. asthma. This linkage increases risks for companies like AEP because it raises questions about the societal costs imposed by supporting coal-fired generation and whether or not citizens will continue supporting its generation. Second, regulations increase the monetary risk for companies like AEP because their imminence reduces the competitive cost advantage that coal users currently enjoy. In total these risks are large in impact and frequency and may seriously affect AEP’s place in the electrical generation industry.

To manage the many risks AEP deals with on a regular basis the company decided to focus on a proactive ERM strategy. This means it is not only being compliant, but also becoming more competitive by building trust with its relevant stakeholders through accountability. To do this AEP first created The Corporate Responsibility report in 2006. This report was presented separately from their financial statements but laid out strategic visions, anecdotal actions, some non-financial data, and qualitative reports on its responsibility as a company. In 2009, AEP decided to create an integrated CSR report with the financial statements that was combined to create The 2010 Corporate Accountability Report, which is a back- and forward-looking document that attempts to link its company objectives with its strategic risks.

Background on AEP: ERM, Organization Structure & Risk Modeling

Enterprise Risk Management is definable in many ways but most commonly accepted as:

“… a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risks to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.” (COSO 2004)

This definition sets the basis for understanding how AEP connects risk management to reporting because it is a common understanding of ERM. To understand AEP’s ERM model it is key to understand the corporate structure of the organization and some background on sustainability as an outcome of stakeholder engagement. Thinking of AEP’s ERM strategy as set by the COSO
framework (*figure 1*), the four components that are key in understanding AEP’s ERM are as follows: strategic, operations, reporting, and compliance. Each of these components is pervasive across the entity and evident in all dealings with risk – from the internal environment to monitoring. The strategic portion is set forth by the management, usually the Board of Directors, CEO, or CRO and applied to operations. The reporting component then reviews what the company’s strategies are in conjunction with the efficacy of the operations group. Finally, the compliance component legally makes sure that what is being reported is compliant with regulations.

AEP’s specific ERM model is an integrated one that connects sustainability, strategic planning, and ERM to each other and to daily risks as shown in *figure 2*.

The model connects the interacting components – strategic planning, ERM, and sustainability – to the operational risk management. As
noted by the model, the day-to-day risk management is created by the strategic planning (i.e. vision, philosophy, and policies) and implemented by operations. The ERM function interacts with strategic planning, day-to-day operations, and organizational sustainability in everything it does because it acts independent of the company and is controlled by the Audit committee. *Figure 3* demonstrates the hierarchy of ERM at AEP, which connects the Audit Committee down to each functional unit’s risk personnel. This reinforces the pervasiveness of risk management throughout the company and demonstrates the importance of risk at AEP. It should also be noted that the CRO is the process owner, which simply means that he or she is pervasive throughout each level of the pyramid and is the final decision-maker at the end of the period.

**AEP’s Risk Governance Structure**

- AEP’s ERM Policy – sets governance structure, roles, and responsibilities
- Board Audit Committee reviews summary report, receives periodic in-depth reports
- REC meetings have strategic focus and discussion of emerging risks
- Independent oversight function reviews risk reports, prepares summary information
- Management of risks
- Provide risk information and analysis

![Diagram](image)

In terms of reporting, the Enterprise Risk Oversight (ERO) Group compiles reports from six different risk baskets, shown in *figure 4* and reports an aggregated report to the Risk Executive Committee (REC). The REC then meets once a month to analyze the reported risks and discuss emerging risks before giving a risk report to the Risk and Strategic Initiatives group, which helps the company understand the internal and external risks and the relationships that connect them. At the same time the Audit Committee reviews the risk management process, then makes an overall company report to the Board of Directors. The Board of Directors assesses the
Audit Committee’s reports and determines the effectiveness of the controls. Finally, the Audit Committee must disclose the risk assessment and management – as part of SOX – in order to assure the company is in compliance.

The actual creation of the Accountability Report is done in conjunction with the reporting group that deals with both the financial statements and with the CSR report. Initially the CSR report was separate from the reporting group and from ERM because each group was thought of as a “silo.” As AEP attempted to enhance the company’s CSR report and better manage emerging risks the two groups (ERM and CSR reporting) kept asking for the same information concerning sustainability (Personal Communication with Sandy Nessing 2010). The company discovered that many of its most important risks were related to or based on sustainability issues (i.e. governmental regulation) and so the risk should be managed together. The two groups then decided to share documents through management tools (i.e. sharepoint) to better manage the flow of information concerning sustainability, the risks, and CSR reporting issues.

While AEP has based its risk appetite on relevant stakeholder impact for years, it was not until recently that AEP tried connecting strategic risks with relevant stakeholders. Relevant
stakeholders, or those stakeholders that are affected by or affect what the company decides or does, are integral to understand AEP’s external risks and why the ERM and CSR reporting groups have an overlapping focus (Ballou and Heitger 2008; Lamberti and Lettieri 2008). Relevant stakeholders play an important role in ERM because they can determine the “…potential events that may affect the entity” (COSO 2004) as well as the possible direct and indirect costs of controlling these risks (Ballou et al. 2009). This focus on relevant stakeholders is a cornerstone of CSR reporting because it effectively displays the connection between business entities and its relevant stakeholders (G3 Guidelines 2006).

In 2006, AEP decided to look at the specific stakeholders’ risks affecting the company to counteract the external risks associated with the relevant stakeholders and realized that many of these were interrelated around the concept of “stakeholder sustainability.” Stakeholder sustainability is often referred to as the Triple Bottom Line and intrinsically connected with CSR reporting because of its focus on the sustainability of environmental, social, and economic issues and how they impact an organization’s actions (Ballou and Heitger 2010). For AEP, stakeholder sustainability became intrinsically linked with its risk strategy because the risk management group understood that focusing on the long-term impact on the world lessened the likelihood and impact of top financial risks. Essentially, stakeholder sustainability became AEP’s view of enterprise risk management.

Many changes in ERM emerged from AEP’s shift in focus to stakeholder sustainability; specifically the integrated 2010 Corporate Accountability Report is crucial because it changed AEP’s ERM strategy from compliant to proactive. The shift created a competitive advantage for AEP to counteract many of the external risks that pertain directly to many stakeholders.

**The Corporate Accountability Report: Vision, Values, and Strategy:**

In order to understand the Accountability Report it is necessary to view the report from a top-down perspective: first, its strategic vision or objective, then a discussion of stakeholder engagement as function of achieving this vision, and finally and the risks associated with stakeholders. AEP’s Corporate website offers the company’s “Vision for Sustainability,” or overall strategic mission concerning global citizenship, which states:

> American Electric Power will be an energy leader through programs and technologies that protect people, manage our impacts on the environment, promote energy efficiency, provide for customer control over
electricity usage and provide for greater access to renewable forms of energy and advanced clean energy technologies. We will work with our regulators and other stakeholders to achieve this through an approach that maximizes the positive economic, social and environmental impacts of our operations.

This vision is the basis for AEP’s strategic focus as a corporate citizen, or member of the socially responsible business world that places importance on CSR reporting. Because this report is specifically focusing on the environmental, safety, and health (ESH) portion of the report, this strategic focus is vital in understanding the promise from which all policies stem and risks endanger. Before proceeding it is important to note why the ESH portion of the report was focused on specifically. While there are many aspects of the report that could be assessed for risks and reporting, ESH is the most applicable for this report because it is the best correlated with other companies’ CSR reports because the environmental, safety, and health issues are often times key components in CSR reports and are also one of the most difficult portions of the report to present accountably and comparably (Eccles and Krzus 2010). Along with this focus is the assumption that trying to focus on the entire report reduces the efficacy of the assessment because it would not allow for in depth focus on a specific risk group.

In trying to determine the accountability and comparability of the ESH portions in the Accountability Report, all risks should be traceable back to the company’s overarching Vision for Sustainability. From this vision the company has created values and strategies that further outline how it attempts to enact the vision. For instance, AEP has created a list of values, shown in figure 5, which develops a corporate culture that focuses on this sustainable vision.

- **Safety** – No operating condition or urgency of service can ever justify endangering the life of anyone. At all times, our first thought and primary consideration is safety for all employees, for customers and for the general public.
- **Justice & Fairness** – Doing the right thing at the right time, every time.
- **Trustworthiness** – Cultivating a reputation of honesty and straightforward communication.
- **Responsibility** – Accepting accountability for your actions and living up to high ethical expectations.
- **Citizenship** – Developing a sense of community among all those you encounter.
- **Respect** – Treating others the way we want to be treated, regardless of position, and valuing each person’s talents, perspectives and experience.
- **Caring** – Maintaining a sincere desire to make the world a better place.

These values are meant to give tangible feelings and perceptions to the employees and promote unified ethical values. These values also motivate employees to make judgments that align with the organizations’ overall strategy. The values can be seen throughout different aspects of the Accountability report. For instance, in the Chairman’s message, Michael Morris writes, “There is simply nothing more important to me, and to our company, than the safety and
health of our employees, contractors and the public.” (p. 3) This statement demonstrates that safety as a value is pervasive throughout the organization and definitive for the corporate culture. It also points to the idea that each of these values is considered an intangible asset that represents value to the company through lower turnover, happier employees, less regulatory scrutiny, etc.

AEP’s philosophy and policies concerning the ESH are key to risk and CSR reporting. These policies can be considered guidelines or applications of the company’s vision. In many ways these policies are the highest guidance employees can use when determining which risks are necessary and which ones are outside of the vision’s focus. As demonstrated in figure 6, AEP’s philosophy is concerned with people’s safety in terms of the environment and health. Along with this overarching strategy, AEP notes specific goals that focus on ESH compliance, employee awareness, environmental performance, and ESH improvement.

<table>
<thead>
<tr>
<th>Environment, Safety &amp; Health Philosophy</th>
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<tbody>
<tr>
<td>No aspect of operations is more important than the health and safety of people. Our customers’ needs are met in harmony with environmental protection.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Environment, Safety &amp; Health Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>AEP is committed to social responsibility and sustainability. We are proactive in our efforts to protect people and the environment by committing to:</td>
</tr>
</tbody>
</table>

- Maintain compliance with all applicable ESH requirements while pursuing the spirit of ESH stewardship;
- Ensure that people working for or on behalf of AEP understand and integrate ESH responsibilities into their business functions;
- Support continual improvement of environmental performance and pollution prevention; and
- Hazard elimination through employee involvement and continual health and safety improvement

What is key in understanding AEP’s vision, philosophy, and strategic policies is that the entire model is permeated with stakeholder engagement. In other words, AEP’s stakeholder sustainability starts with a high level vision and connects internally and externally to all relevant stakeholders. These stakeholders, specifically the ones associated with ESH will be discussed in the next section.

The Corporate Accountability Report: Stakeholder Engagement

AEP’s strategy towards stakeholders starts with trust. It is imperative for the success of the business to focus on the relevant stakeholders because the external risks associated with the electric industry are extremely high. For instance, President Obama commented in the 2011 State of the Union Address, “By 2035, 80 percent of America’s electricity will come from clean energy
sources.” (New York Times 2011) If this becomes reality through renewable energies only – i.e. wind, solar, or geothermal energies – AEP will have to change or lose 66% of its total energy feasibility – essentially bankrupting the company. This example highlights the risks associated with possible regulatory change because President Obama’s comments favor states with clean energy resources (i.e. sun, wind, or geothermal capacity) and could significantly harm the areas of Appalachia that are rich in coal, which is where AEP currently purchases. It also demonstrates the need for AEP to manage their external risks with their stakeholders because politicians like President Obama need to understand the differences between regions and how energy is produced in each of those regions.

To counteract the many risks associated with electricity generation AEP has utilized its sustainability strategy to be “proactive in our efforts to protect people and the environment” (above) by attempting to develop trust through transparency with their stakeholders – whether these stakeholders support them or not. This stakeholder engagement is key in ERM because stakeholders are liable to cause the company the direct and indirect costs associated with controlling, detecting, or repairing the possible outcomes associated with these events (Ballou et al. 2009).

AEP’s stakeholder engagement strategy focuses on stakeholder meetings that serve dual purposes: first, to provide the company outside opinions and insights from people of diverse background. For instance, each stakeholder meeting attempted to contrast strong viewpoints like those from Bill Raney, a strong supporter of coal power generation from the West Virginia Coal Association, and Matt Wasson, an opponent of coal power generation from the activist group Appalachian Voices. Bringing these very different stakeholders together made these meetings “boxing matches” between the various stakeholders because tensions were so high (Personal Communication with Sandy Nessing).

Second, to get stakeholders to realize that AEP is under stress from competing interests – i.e. coal suppliers and anti-coal advocates. As the stakeholder-meeting champion, Sandy Nessing, stated, “the stakeholders are stakeholders of each other.” Each group is affected by and affects other stakeholders as much as they affect AEP. This is critical for AEP to display to its stakeholders because the stakeholders must understand that AEP cannot make tradeoffs between sustainable power generation and cost recovery, but instead must utilize creative alternatives to manage the risks associated with each stakeholder.
Another key factor in these engagement meetings is AEP’s inclusiveness. AEP attempts to represent all relevant stakeholders in the stakeholder meetings and in the Accountability report including: shareholders, customers, labor, legislators, regulators, policymakers, employees, prospective employees, suppliers, professionals in industry and academia, communities and non-governmental organizations (NGOs). Each of these stakeholders are included as primary or relevant stakeholders based on how each of these stakeholders is impacted by and impacts each of AEP’s material issues or those that:

1) Have or may have significant impact on the company’s finances or operations; 2) have or may have significant impact on the environment or society, now or in the future; or 3) can substantially influence the assessments, decisions, and actions of out stakeholders and shareholders. (CAR 2010)

These issues link back to the relevant stakeholders because AEP’s recognizes these material risks and can link them to the specific stakeholders in a correlative manner. This stakeholder inclusion enables the company to focus on stakeholder engagement as a function of ERM, which one way that the company aligns strategic objectives through operations and into reporting.

Finally, stakeholder engagement is reflected throughout the Corporate Accountability report’s sections by focusing on eight distinct sections: financial performance; energy security, reliability and growth; public policy; environmental performance; global climate change; workforce; and stakeholder engagement. However, because of the limited focus of this report only the public policy, environmental performance, global climate change, workforce, and stakeholder engagement will be assessed.

The Corporate Accountability Report: Risks in ESH Reporting Group

There are many risks that could affect AEP’s vision, values, and strategy based on the ESH reporting groups presentation of information. These risks range in scope from industry wide ones (i.e. possible regulatory change) to event specific ones (i.e. reporting on the stakeholder engagement meetings) and vary widely in their impact. Couple this risk variety with the difficulties of reporting nonfinancial information (i.e. lack of regulation) and it becomes apparent why companies in the U.S. rarely externally assure their financial CSR statements.

To discuss the risks that the ESH group must manage it is first important to note what “reporting risk” means. To define reporting risk it is first important to understand “risk” and
more specifically “economic risk.” Risk is “the likelihood that an [organization] will experience the effect of danger” (Sjöberg 2004). Taken this a step further, economic risk is “the risk that a business will not generate sufficient revenues to cover operating costs and to repay debt obligations.” (Inventory Capital Group, Inc. 2011) What these definition point out is that to report on risk a company must predict and quantify events that may or may not happen and how these events can reduce revenues. Thus reporting risk is the likelihood that an organization will experience events that endanger the companies revenues based on what it reports. To manage these risks a company must make statements that can be “assured.” To assure something is to reasonably guarantee it. This means that company only makes statements on their report because it believes the statement to be true and is willing to let outsiders rely on that information. This assurance is common practice in financial reporting but more difficult in CSR reporting because of accountability and comparability problems.

Accountability is one problem associated with CSR reporting risks because there are no regulations concerning CSR reporting and companies could misstate simply to market a better business image – also known as greenwashing. For AEP to make statements that will represent the company’s ESH risks without greenwashing the readers of the report, the statements must have support to back the information. This support is a challenge in risk reporting because any quantification of a risk is simply an educated guess because risks are inherently possibilities; they may or may not happen.

Support information is also a challenge for risk reporting because the numbers are nonfinancial and are thus difficult to compare. The lack of comparability across industries makes any CSR report that discusses the possible risks affecting the company liable of material misstatement because the information presented is based on assumptions that could differ company to company and from reporting period to reporting period. This is also a lack of regulation problem because the organizations that create guidelines for CSR reporting are still in their infancy with less-than-perfect guidelines to assuage these risks.

When looking at the various risks that AEP’s ESH reporting group focuses on it is important to think about the risks from the group’s perspective. One way to do that is to view the company’s risk as an auditor would; this represents a similar viewpoint to the reporting group’s risk analysts because they act like internal auditors. Auditors gain much of their knowledge from an understanding of the industry a company competes in and then develops a framework that is
applicable to the company. For this report a basic auditing framework was developed and applied to determine the key risks categories that could affect AEP. This framework was broken into eight categories including: the threat of competitor companies taking business, poor sustainability practices by suppliers, rate payer protests, new entrants or substitutes, economic, political, social/perceptual and technological risks. Each of these categories does not necessarily represent what AEP did report on, but rather common risk areas for most publicly traded companies. The purpose is to understand the risks associated with AEP’s ESH reporting group and how these risks affect the CSR report.

*The Threat of Competitor Companies Taking Business:*

The risks associated with competition in the electrical industry are unique. Because the industry is heavily regulated the risks associated with new entrants or competitor cannibalization is low; the government restricts the companies that can put electricity into the grid through regulated prices and licenses (Michaels 2003). Specifically, laws currently prohibit individuals from connecting to the energy grids in the U.S. and regulate businesses that do heavily. But if this were to change with advent of individual- or community-based solar or wind generation this could have significant competition risks for companies like AEP. However, the likelihood is low.

It is important to note that AEP is the largest generator and distributor of electricity in the U.S. As such, there is some risk of other electrical companies stealing its business, but the trend since the deregulation of the industry has been for electrical utilities to support each other’s energy grids in periods of high demand through energy swaps rather than taking each other’s business (Michaels 2003). This is mainly because consumers do not shop for electricity providers, as they would cable providers, rather they purchase what is available and rely on set prices or wholesale markets by municipalities. Thus, the competition risk will not be focused on in this report.

*Poor Sustainability Practices by Suppliers:*

A major risk for AEP’s ESH group is where the company’s coal suppliers are mining coal and how the mining is being accomplished. Currently over 90% of AEP’s coal suppliers procure from three places – The Powder River Basin (Montana/Wyoming), Northern and Central Appalachia (West Virginia). The report does not, however, specify the supplier of the coal. AEP
calculated that 7% of coal production came from mountain top mining (arguably the least “clean” form of coal procurement), which indicates that a significant portion of AEP’s business comes from suppliers who do not support environmental sustainability or cannot feasibly procure the coal from other means (CAR 2010). This is a major risk for AEP because this form of coal procurement has been linked to increased cancer and asthma rates – both human and environmental health hazards (Meiji 2004).

At the same time AEP has the risk of job loss in these regions. The Appalachian portion of the U.S. is one of the most economically depressed areas in the U.S. and a loss of thousands of jobs would only further impoverish these people (U.S. Census Bureau 2010). The risk that AEP walks here is between two opposing viewpoints on energy and the economy that makes the company’s risk management strategies very difficult. This is one of AEP’s largest risks to assess and control.

Ratepayer Protests:

AEP is in a partially regulated industry and must interact with both state negotiated rates and wholesale prices. This risk is key for AEP because, as Sandy Nessing, The Director of Sustainability and ESH Strategy & Design at AEP, stated “Electricity is personal. It’s in your life every day” (Personal Communication 2011). This means that electrical utilities live in a catch-22; ratepayers mistrust the utilities even if the utilities cannot set the rates that are charged to the customer. Even still, AEP must keep state constituents and electricity users content because the ratepayers naturally mistrust the company. To manage the tensions between ratepayer satisfaction and profitable pricing is another influencing factor for AEP to continue producing electricity from coal generation; coal production is cheap and located far away from many taxpayers’ homes (often referred to as “Not-in-my-backyard” or NIMBY). At the same time consumers want electrical utilities to produce energy from more renewable sources, which would drive prices – and levels of mistrust - higher. It is a difficult risk to manage for a company like AEP.

Another important aspect of ratepayer protests is its linkage to political risks. Because of the high regulatory demands on the electrical utilities industry, AEP must view part of the ratepayer protesting risk as a political risk. The sequence of action usually follows a series of events including: protests, congressional demands, congressional regulatory or policy changes,
and finally an effect on the company. This line of events makes the linkage between ratepayers and AEP a third party one, with the government being the conduit through which the process flows. Thus ratepayer protests are intrinsically linked with political risk.

New Entrants or Substitutes:

Much like the threats from competitor companies, the electrical generation industry does not currently have a high likelihood of new entrants or substitutes. Everyone needs energy and it cannot be imported from another country so the industry itself is safe.

Economic Risks:

AEP has a variety of risks associated with the economy. For instance, coal is a commodity and the prices fluctuate with the market, making AEP susceptible to market fluctuations. The risk here is specifically focused on issues of bear and bull economies. For instance, the recent recession hurt AEP’s stock price and profitability because they align so closely to the fluxes in the economy. Thus the risk is financial, well-documented in the financial statements, and of lesser importance in terms of ESH or CSR reporting – economic risk will not be focused on in this report.

Political Risks:

Political risk is probably AEP’s largest external risk because so much of the industry is reliant on policy and regulation. It is important to differentiate between the two because policy acts on a larger scale than does regulation; policy sets regulation and creates incentives for the energy sector. For instance, President Obama urged Congress, “…to eliminate the billions in taxpayer dollars we currently give to oil companies.” (NYtimes 2011) This would be an example of a non-regulatory policy change. Regulation, on the other hand, is a set of controls that the government deems necessary to the United States and mandate companies to follow them by policy. The distinction is critical for AEP because policy sets AEP’s prices but regulations mandates what is reported or protected legally.

Of specific interest to AEP is changing policy concerning the environment and energy generation. AEP supports the Waxman-Markey Bill (also known as the American Clean Energy and Security Act), which sets up a greenhouse gas emissions trading system that would regulate
the generation of energy and company specific pollution standards (Open Congress 2010). There are many risks associated with supporting this regulation. For instance, one provision of the bill was to make all electric generation companies produce 20% of their energy from renewable sources by 2020. This could seriously affect AEP’s profitability in the next decade because the company only produces 6% of its energy from renewable energy currently. The risk in policy change is both likely and could severely impact to AEP, which is why it is AEP’s top risk.

It also important to note that part of the risk the ESH group reports on is safety and health risk. The policies and regulations concerning safety is a well-defined field of study that will not be focused on heavily, though healthcare policy change is currently a hot political topic. AEP has an aging workforce that relies on AEP for affordable healthcare; there is potential risk that changing policy could financially burden the company now or in the future. This is not a top risk, but it is of importance.

*Social and Perceptual Risks:*

The second largest risk for AEP is social risk. In terms of social risks, “perception is reality” as Sandy Nessing stated because AEP is the largest user of coal in America and so it has become the face of coal to the American people. Since coal production is being debated heavily in America right now it is no surprise that this risk is key to AEP’s long-term sustainability. One major reason why AEP has created a proactive ERM strategy and reporting practice is to dispel the image that it is a “profit hungry company who doesn’t care about their impact” as noted by one activist who lives in Gallia, Ohio (which is located adjacent to three of AEP’s coal-fired generation plants). This sentiment is a difficult one to manage and even harder to change.

It is important to note, however, that this is the second largest risk because many of the actions that can significantly harm AEP still happen through the government, meaning that social risk can push for change but in the end it is the policymakers who will determine the fate of the energy industry. This does not mean, however, that AEP should underestimate the power of grassroots environmental or community activists. These stakeholders are an outspoken group of the population that affects voter and policymaker decisions very heavily.
Technological Risks:

In an age of information and innovation, technological risk is present for every company and especially for energy companies. It is important to understand that technological risk can take many forms. For instance, coal-fired energy generation technology is increasingly becoming outdated as human hone the craft of wind, solar, nuclear, and geothermal energy creation. At the same time CSR reporting is an information technology that is changing how companies present themselves. These two examples demonstrate that the risk of changing technology varies widely by field of study and is certainly an important risk for AEP.

Of specific interest to AEP, however, is in developing technologies for energy generation and transmission. For instance, AEP’s 2010 Accountability Report focuses heavily on Carbon Capture and Sequestration (CCS) as a form of “clean energy generation.” Critics would argue that this form of “clean” energy generation is not actually clean because injecting liquefied carbon dioxide into impermeable rocks is not sustainable or renewable, it is simply “cleaner” than not doing anything to the emissions. This demonstrates the importance of technological risks because energy generation is the backbone of AEP’s business and the profitability of the company is dependent on how the company manages technological changes in energy production.

Risk Assessment:

In the introduction of this report two key CSR reporting problems were identified as major problems for most companies: accountability and comparability. This portion of the report will expand on these two major CSR reporting issues and focus on four reporting issues that are common across financial and CSR reporting: accountability, completeness, logical assumptions, and comparability. Optimally AEP would like to be completely transparent to their stakeholders, but the challenges listed below force companies to make tradeoffs between full disclosure and disclosure risk. It should be noted that the reason that the two major reporting issues were further bifurcated into four categories is for ease of discussion; each of the challenges can mix and mingle with one another, but for terms of clarification four will be used to show a strong characterization of the report.
• **Information accountability:** There is little regulation currently overseeing how AEP is identifying and reporting its non-financial numbers, and it makes the report’s transparency weaker. There are non-mandatory guidelines that AEP used for the report that are well respected as guidelines for more transparent reporting. These are called the GRI guidelines (Appendix A) and are meant to critically benchmark, demonstrate, and compare the company’s performance indicators in environmental, social, and economic activities to provide a clear picture of the company’s long-term sustainability.

• **Completeness (or lack of omission of details or numbers):** If AEP simply ignored information because it is difficult to quantify (i.e. mercury particulates in the air) then it would be misrepresenting information through a lack of transparency. If a number is difficult to quantify it is better to state “we do not know” and offer a simple assumption of what it could be. This, of course, will be critiqued but it is better than lacking the transparency by omitting it completely.

• **Logical assumptions of non-financial information:** A strategic analyst at AEP discussed quantification as a problem of qualification, “People want one specific number that they can rely on; the reality is that modeling is possibilities based on correct underlying assumptions.” This means that the quantification of non-financial numbers can be crunched all day, but if AEP can neither actually understand what is being reported nor correctly measure key numbers than the quantifications are worthless.

• **Comparability across time and industry:** For CSR reporting to become truly transparent it is necessary to make the numbers comparable against themselves and against other companies within the energy industry and outside. This is probably the most difficult task for true transparency because it forces companies to create normalized information that relates not only to their business but also to other businesses.

Each of these challenges has a varied impact and likelihood of occurrence. In assessing risk it is critical to take into account both the magnitude of the risk and the frequency of occurrence as shown by the function:
Risk  = f x (l x o), where f = probability, l = loss per unit, and o = total units of output

The magnitude and frequency of the risk takes into account the future aspects of risk in terms of a “what if” analysis. This analysis essentially quantifies the cost of the risk – whether it is direct monetary cost or indirect non-financial costs that will eventually impact the business – based on a matrix of different indicators that will place any risk in one of four quadrants as demonstrated by figure 7. If the risk falls into the high category, then it needs dealt with immediately. If the risk falls into the low category then it can essentially be ignored or monitored efficiently because the response cost will likely outweigh the potential benefit. The challenge, therefore, is in the two moderate categories where the risk either has low impact but high frequency (i.e. daily operations) or high impact but low frequency (i.e. the threat of terrorism).

In looking at the eight categories of risk identified for the ESH reporting group, each risk will assume one spot in the matrix based on the impact and probability of the risk for AEP as shown by figure 8.
As this matrix demonstrates, the key areas of focus to report on are in the high-risk category because they occur frequently (i.e. public perception is always changing) and have a heavy impact on the company (i.e. emissions trading will be very costly for AEP to manage). This aligns closely with the earlier discussion of the risks the ESH reporting group manages because supplier practices, policy & regulation, emissions trading, public perception, activism influence, and changing technologies were all key reporting risks. It should be noted that some of these risks impact different stakeholders, though they are still displayed in the same risk group. For instance, public perception and activism influence different stakeholders but both are related in that they are social risks. In these cases, the stakeholders will gather for a cohesive discussion of a specific risk rather than a discussion of each stakeholder separately.

**An Assessment of ESH Information in the Accountability Report:**

Turning directly to the Corporate Accountability Report, AEP’s internal audit team graded the report based on the GRI standards for CSR reporting and deemed the report an “A”, which means that the reporting group met all requirements for a strong CSR report but lacked external assurance. What is key for this study, however, is to determine how well AEP addressed the four challenges in reporting – information accountability, completeness of information, good assumptions, and comparability – in each of these high-risk areas. This will be determined with a qualitative grading system that identifies the areas where the report is very strong and areas where it could use work. Considering that AEP is ahead of the curve compared to its competitors, only three grades will be given to demonstrate the report’s efficacy in addressing the four challenges of reporting. An “excellent” rating means that the report was very strong, addressing all the challenges well. A “satisfactory” rating means that they addressed most of the challenges, but could use some work to make the report excellent. A “needs improvement” rating means that the report did not address the challenges well and should be re-evaluated for changes. An overall grade is given to demonstrate effectiveness of the report. The nature of the grading is subjective, but will attempt to stay objective by checking the information with professionals in the field.
Addressing Supplier Perspectives and Practices, Grade: Satisfactory

American Electric Power’s overall approach to addressing the differing supply chain perspectives and practices is best summarized by the report’s main objective on the subject, “Sustainable supply chain development is still new to the utility industry but has become increasingly important as we seek to reduce our environmental impacts” (additional information “environmental performance”). This statement makes note of the challenges and the goals that the company deems important in addressing the two major risks associated with AEP’s suppliers: environmental impact and economic stability. It also demonstrates that AEP’s underlying assumptions are very strong because they are the main objectives of the company’s reporting.

The 2010 Accountability Report also denotes an entire portion in the “environmental” section dedicated to “Working With Our Suppliers” where AEP discusses the relationship between suppliers and energy generation. Supplemental information is offered online access about a supplier survey that attempts to benchmark supplier performance in key areas including: health and safety, environmental performance, and coal top mining issues. This survey shows that AEP is presenting a strong, accountable record with the company’s suppliers and the impact the suppliers have on the environment.

The report also admitted AEP’s inability to compare the received statistics from suppliers to any outside meaningful information because a lack of government supported information sharing on the topic. This demonstrates a focus on accountability because it admits the difficulties that AEP must manage because it is proactively addressing an issue that has long been ignored by electric utilities. It also demonstrates why the completeness and comparability aspects of the report are weaker than the assumptions and the accountability, which strengthens the overall report.

The supplier survey is a positive starting point in terms of transparency, but lacks completeness by withholding some information. For instance, the survey offers information on the total amount of coal purchased in 2008 (78 million tons) and the regions that the coal was purchased (Appalachia, Gulf, Illinois Basin, etc.) but does not indicate which suppliers the names of AEP’s suppliers, nor individual supplier performance. It is understandable that AEP is attempting to keep suppliers names discrete to encourage supplier participation in the voluntary survey but it does weaken the transparency of the data because of representation problems. For instance, what if the 82% of suppliers that responded to the survey were the “cleaner” suppliers
and skewed the data to show AEP’s coal purchases as less harmful on the environment? This example demonstrates a possible omission of data that affects AEP’s overall transparency.

The survey also omits economic information about the suppliers. For instance, the survey could have asked questioned of the supplier’s net income or average worker wages compared to the median wage in the area to demonstrate areas of the country where mining is essential to the livelihood of the residents. This information would be especially helpful for AEP to make comparisons on the tradeoff risks between environmental sustainability and economic development that would better highlight AEP’s precarious position.

While the other topics discussed in this portion of the risk assessment can be addressed fairly easily, the main challenge for AEP in this reporting area is in comparability. Comparability is an issue for two reasons: First, AEP admits that this is the first survey of its kind so the information is essentially incomparable in both period comparisons and in industry comparisons. This weakens the accountability report’s ability to present supplier information in relation to other companies’ suppliers and across different reporting periods, which weakens the veracity of the data.

Second, the information available in the report could be better presented. The report relies heavily on descriptions of supplier relationships and challenges even though there is enough information given that quantifiable numbers or visual representation of data could be reported. The report forces readers to dig for information when it would be more useful for stakeholders to see graphs and charts that would align with the statements being made. While it is important to put information into context, there are better ways to do so by making the information more visual. For instance, the report offers a visual aid about the location of the coal it purchases by region of the U.S. It would be helpful if the report also offered visual aids for environmental performance, safety and health standard performance, or accident avoidance – for instance, figure 9.
shows the environmental performance among suppliers taken from AEP’s supplier survey. These visual aids would better represent the information AEP received from the surveys and would make the report significantly more comparable.

**Linking Policy & Regulation to Strategy: Satisfactory**

The Accountability report presents policy and regulation information in two separate sections: Public Policy and Environmental Performance. AEP focused on the changes in public policy concerning alternative rate systems, energy efficiency, transmission, and lobbying. Each of these policy changes is discussed from AEP’s perspective and the company’s performance. The issues are well linked to the company’s strategy concerning its sustainable vision, which states, “American Electric Power will be an energy leader through programs and technologies that protect people, manage our impacts on the environment, promote energy efficiency, provide for customer control over electricity usage…” This again points to a strong understanding of key assumptions dealing with policy and regulation by linking these strategies to what is being reported.

In terms of accountability, the issues presented in the report are well represented from multiple angles with supporting information online. For instance, the report devotes an entire section on “Compliance Performance & Management,” which presents relevant information on key issues in a “Regulatory Landscape Changing.” The report discusses coal ash, air quality, water issues, waste reduction, and land issues – all are critical for an electrical utility that generates electricity from coal-fired plants. Within each of these issues, the report discusses why the issues are important, how AEP is currently performing, and offers future goals and targets (in the online appendices). This presentation demonstrates a strong accountability surrounding the issues, with supportive facts and narratives that help readers understand AEP’s perspective.

The report has difficulty presenting comparable data, however. For instance, in the “Environmental Performance” section of the report a pie graph is given reporting on the systemwide releases of hazardous metals into water systems. While the graph is helpful for stakeholders in terms of what is being released into the water systems, the information needs normalized. The example used shows that 192,639 pounds of metals are released into the water systems by AEP, but does not present the information per plant or per kilowatt-hour generated. To put the information in context, the EPA allows the electricity industry to dump an aggregate 2
million tons of metals and metal compounds in the water systems. This would lead one to believe that AEP is therefore dumping 10% of all metals and metal compounds of the industry. Does this mean that AEP’s effluent would be considered low, normal, or high compared to industry standards? Essentially this means that AEP needs to normalize the information to better quantitatively represent the company’s regulatory pressures surrounding issues like environmental impact to better guide the reader from strategies to risks and actions (Abbott 2010).

*Presenting Global Climate Change and Emissions Trading: Improvements Needed*

Despite devoting an entire section of the Accountability report to these issues, entitled “Environmental Performance: Climate Change,” the report offers a less than satisfactory presentation. The report does outline the important assumptions and risks on the subject – i.e. energy generation, emissions, impact, and possibilities if legislation were to occur – but has trouble addressing the issues of accountability, completeness, and comparability. For instance the report offers some aggregated graphs and figures but offers few specifics that pertain to the subject of climate change. This weakens the report’s accountability because it could be construed that the company is attempting to greenwash this portion of the report by offering the principles that are part of the company without offering the actions that AEP is practicing to enact these principles.

As with suppliers, the report offers some non-financial quantifiers that could be utilized to present comparable information but does not fully represent the information. This is partially an omission of information and partially a lack of comparability because the report represents a significant portion of information, but the information does not make sense to the average investor or stakeholder. For instance, a lot of the information AEP reports (i.e. the metric tons of CO₂ the company emitted in 2009) is evident in the report but lacks relevance because the information is not normalized. If this information were normalized it would enhance the report because it would better demonstrate to stakeholders the impact of emissions per dollar or per energy source (i.e. how much does coal cost compared to its emissions). This would make the information much more relevant to individuals who wanted to compare AEP’s information across time and across industry.
The report also omits some information concerning climate change policies that the company supports. For instance, AEP supports the Markey-Waxman bill but does not discuss the details of the bill nor does it present other alternatives and why AEP does not support them. This omission of information reduces the transparency of the report because it presents only what AEP supports and not the complexities and risks behind the issues themselves. One way these issues could be better represented is in a risk matrix – i.e. each of the different policies could be compared in one normalized chart based on monetary risk to the company. An example of this was presented earlier in the report (pp. 30) and could certainly be utilized to better demonstrate the risks associated with climate change.

Another weakness in the reporting is the reporting on renewable energies. There is significant literature concerning renewable energies, but almost none of it is presented in this report. For instance, the report discusses “Technology” for addressing climate change and then only discusses carbon capture and sequestration (CCS) and sodium sulfur battery storage. While it is important for the report to mention what AEP is doing, it is also important to demonstrate why AEP is not doing other activities. As it currently is presented, there is no actual discussion of, “…greater access to renewable forms of energy and advanced clean energy technologies,” as is stated in the company’s vision. A better portrayal of this subject would involve the many developments in biomass production, wind, solar, or geothermal energy production and why or why AEP is unable to focus on these technologies. This is a key weakness in the report because it reduces the accountability of the report through large omissions of information and reduces the stakeholders’ ability to compare to other companies in the industry. This will be re-visited in the “Linking Technological Reporting to Strategy” but certainly correlates with climate change since many of the technology risks AEP faces are on this issue.

Managing Public Perception and Activism Influence: Excellent

Public Perception and Activism Influence are best discussed in unison because the risks associated with these issues are interwoven. One of the report’s key foci is the occurrence of the stakeholder engagement meetings that AEP hosted between environmentalists and suppliers (among other stakeholders). In terms of underlying assumptions this is an excellent presentation of the company’s understanding of key issues concerning the public perception. The report discusses the different factors that affect AEP, the reasoning behind affectations, and how their
materiality is key for the company’s long-term sustainability. Also, in speaking with Sandy Nessing it became immediately apparent that stakeholder engagement was an important part of AEP’s strategy, the company understood the risks involved, and the report reflected this understanding.

In terms of accountability, the report accurately discusses public perception through stakeholder engagement and – more importantly – through the key stakeholders own words. The report even offers opposing activists opinions on important issues like coal-fired generation. The report also offers many nonfinancial indicators and anecdotes that relate back to overall strategy and the risks involved. All of these aspects of the report demonstrate that the company is connecting its strategy to the risks associated and presenting transparent information on the subject.

Public perception is difficult to make comparable in terms of nonfinancial quantifiers, but the report does quite well with its anecdotes. Multiple portions of the report discuss different stakeholders’ viewpoints and how they conflict with each other. This anecdotal representation of different opinions is also supplemented with facts concerning the numbers of stakeholders and meetings. This shows that the comparability reporting risk is adequately addressed in the 2010 Corporate Accountability Report.

While the reporting risks are well addressed by the report, the report does omit some aspects of public perception. For example, I personally met with a couple groups of activists that live near a group of generation plants in southeast Ohio who felt they were underrepresented in the stakeholder meetings (Personal Communication with Elisa Young). This omission can either be for one of two reasons: first, the company did not see these activists as material to the company. If this is the case, it should be stated why the local communities near the generation plants are not material stakeholders. Second, the company did not realize that these activists were underrepresented. If this is the case then AEP could try to make the stakeholder engagements more known to the public, though it is understandable why the company desired to keep these “boxing matches” small. Either way, this omission of information is minimal in comparison to the positive aspects of the report, which is why this reporting risk is excellent.
Before discussing the areas of the report that could be improved concerning technology risk it should be noted that the 2010 Corporate Accountability Report does not address “technology” or “technological change” as a specific risk. Yet when looking at the criteria that AEP uses to define “material issues,” or risks, it can be shown that technology “may have a significant impact on the company’s finances or operations” through its ability to change and therefore affect the competitiveness of the company (Porter 2008); technology “…may have a significant impact on the environment or society, now or in the future” through its ability to mobilize public perception (as seen with social networking in Egypt’s recent overthrow); and technology “can substantially influence the assessments decisions and actions of our stakeholders and shareholders” through advances in empirically measuring and corporate reporting (i.e. the importance of key performance indicators). All of these criteria point to technology – and more importantly change in technology – as a material issue for AEP that should be better understood strategically and linked to stakeholders to ensure long term business sustainability.

The nature of technological change is quite difficult to predict. This is possibly why AEP does not explicitly address the subject in the 2010 Corporate Accountability Report. In fact, the report only directly mentions technology and technological change in one portion of the “Environmental Performance: Climate Change.” It does inadvertently address technology issues throughout the report but never ties these issues together. The major weakness in this approach is that it could lead stakeholders to view the report as a reflection of AEP’s misunderstanding of the risks associated with technological changes. This could be an assumptions fault or an omission of information but it reduces the efficacy of the report because it skews how AEP presents its view of technology.

In terms of accountability, the report does mention some advances in environmental technologies – i.e. clean coal, wind, solar and energy efficiency. But, as aforementioned in the “Presenting Global Climate Change and Emissions Trading” portion of this report it does not give a holistic discussion on the topic. This lends a reader to believe that AEP is not being accountable about technological changes and reduces the transparency of the report. Considering that the assumptions surrounding technological change and the accountability on the subject are weakly presented in the report, it makes sense that the report is also incomparable in
this same topic. It is difficult to compare a topic that needs structural adjustments because a baseless topic can really only be compared to itself.

For future reports AEP should address its understanding of technological change as a key material issue and should look into devoting a portion of the report to “Company Performance in a Changing Technological Environment.” One topic that could be utilized is the differences in electricity-generating technologies. For instance, clean coal technology is a hotly debated topic as to whether it truly is a “clean” energy source or just a “cleaner than regular coal burning” (Walsh 2009). If the report discussed the different renewable options – such as solar, hydro- or geothermal energies, wind, or even tidal energies – and why they are or are not feasible for the company it would provide a stronger level of transparency. It would also create a basis for AEP to compare its energy sources and technological changes to other companies in the electricity industry and elsewhere.

**Overall Grade:** *Satisfactory*

The report is satisfactory because it offers both excellent areas (public perception reporting) and areas that need improvement (technological change). It offers much more information than its competitors (i.e. Duke or FirstEnergy) but it still has a long way to go before it can be comparable to very strong CSR reports (i.e. BT or NovoNordisk). Overall, the report lacks strong comparability. This is most apparent in the figures that are not normalized and in the anecdotal nature of certain portions of the report. These reporting challenges are difficult for a company to address but will add significant value if they are correctly utilized. For instance, *Figure 10* demonstrates how BT reports nonfinancial information in a very comparable manner. Readers can connect the company’s key indicators to normalized numbers that relate across reporting periods, which makes reading the report significantly more understandable and transparent. This is just one example of how AEP can better its report, but it does demonstrate the fact that the Corporate Accountability report has some room for improvement.
Conclusion:

This report has assessed AEP’s 2010 Corporate Accountability Report from a risk management perspective that attempted to judge the efficacy of the report based on the areas of CSR reporting that are key for strong reporting practices. Through this venture the report discussed the company’s ERM structure and how ERM connects with CSR reporting. This report also peered at the strategy and risks associated with the ESH reporting group and how well the company did in presenting the risks that affect the company from external sources. Using a
general risk-audit framework this report viewed the risks that the company should report and the challenges associated with reporting these risks. The risk assessment then took a basic auditing framework and assessed the report based on how well the company addressed each of the challenges that could strengthen the report. Overall the report addressed the risks at a “satisfactory” level because it was overall accountable with strong underlying assumption but lacked normalized nonfinancial quantifiers and therefore reduced the comparability of the report to other companies and across reporting periods.

Corporate Social Responsibility reporting is still in its infancy. But it is companies like American Electric Power that are moving and advancing the field. These companies realize that financial statements do not represent the company’s long term sustainability well enough and there needs to be a more holistic reporting methodology in place that will demonstrate that companies are both financially stable and socially aware. AEP is doing this because it realizes that it can gain a competitive advantage by linking long-term strategies with proactive reporting. But should these companies be the only ones responsible to move forward the reporting industry? Should CSR reporting become a mandatory part of reporting, as it is in France and Sweden? Or will this overburden companies and make them less economically efficient? This paper does not directly address these issues but it does assess the efficacy of CSR reporting and makes the argument that one of the better publicly-traded U.S. companies has room for improvement, giving credence to the fact that all U.S. companies can report more holistically.
Works Cited:


Appendix A: The Global Reporting Initiative

The Global Reporting Initiative (GRI) is an organization that creates a set of guidelines, called the *G3 Guidelines*, created to measure, disclose, and be accountable for organizational performance towards the goal of sustainable development. Sustainable development is defined as “meeting the needs of the present without compromising the ability of future generations to meet their own needs.” Essentially the GRI’s purpose is to put non-financial information into context and to provide a balanced, reasonable representation of the sustainability performance of an organization.

The GRI Reporting Framework was created to serve as a comparable and generally accepted framework for reporting “an organization’s economic, environmental, and social performance.” Key components of the framework include: Benchmarking, demonstrating, and comparing positive and negative performance within and across organizations. This is demonstrated in the figure below, which is taken from the 2010 GRI reporting guidelines.

Using this framework, companies can determine how and what to report in the CSR reports they produce. Companies are also encouraged to request an application level from the GRI that determines the how strong their sustainable reporting initiatives are. This is demonstrated in the figure below:
American Electric Power received an “A” by the GRI on their Report Application Level because they met all requirements in the G3 Profile Disclosure, Management Approach Disclosure, and G3 Performance Indicators & Sector Supplement Performance Indicators. For example, under the G3 Profile Disclosures section 1.2 AEP described their key impacts, risks, and opportunities of 2009. Each of these requirements can be further explored in the GRI Reporting Guidelines (G3 Report) for 2010.

The GRI reporting initiative is relatively new and is uncommonly used in the United States. Even less commonly used are the energy sector specific guidelines in the G3 guidelines. These were actually tested by AEP in 2006 with the original Corporate Social Responsibility Report. Sandy Nessing, the Director of Sustainability and ESH Strategy and Design at AEP, worked with GRI executives to test out the new electrical utility sector specific guidelines that focus on “Putting [data] information into context.” This experiment later evolved into AEP’s Integrated 2010 Corporate Accountability Report, but it is important to note that AEP willingly participated in trying to set the standards for all electrical utility companies that were looking at using GRI guidelines.

At the same time, the G3 Reporting Guidelines are still weak because of comparability issues. Many of the key indicators are not easily quantifiable and are either qualified or omitted,
which is a large reason why companies do not want to spend the money on external assurance: external auditors cannot “reasonably assure,” or guarantee, that the assumptions, quantifications, and risks will hold up in a U.S. court of law. On top of that, the key indicators are non-financial and therefore are difficult to compare industry by industry or even company by company and so the GRI reporting initiatives remain part of proactive companies rather than becoming part of every publicly traded company through regulation. This weakens many companies support for the GRI’s movement and undermines better reporting overall.